

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
PETITION FOR
REHEARING
EN BANC**

77-7013

ORIGINAL

UNITED STATES COURT OF APPEALS

for the
SECOND CIRCUIT

BROWNING DEBENTURE HOLDERS' COMMITTEE...;
SIMMS C. BROWNING...; and
ROY E. BREWER...;

Plaintiffs,

ROY E. BREWER and
SIMMS C. BROWNING,

Plaintiffs-Appellants,

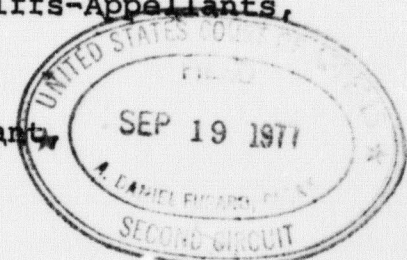
BRADLEY R. BREWER,

Appellant,

-against-

DASA CORPORATION,
ARTHUR ANDERSEN & CO.,
THE BANK OF NEW YORK, et al.,

Defendants-Appellees.



ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR
THE SOUTHERN DISTRICT OF NEW YORK

PETITION FOR REHEARING EN BANC
OF APPELLANTS ROY E. BREWER
AND BRADLEY R. BREWER

Of Counsel:

Bradley R. Brewer

Dated: September 16, 1977

BREWER & SOEIRO
ATTORNEYS AT LAW
257 PARK AVENUE SOUTH
NEW YORK, N. Y. 10010
(212) 777-4010

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BROWNING DEBENTURE
HOLDERS' COMMITTEE, et al.,

Plaintiffs-Appellants,

-against-

DASA CORPORATION, et al.,

Defendants-Appellees.

Docket No.
77-7013
77-7014

PETITION FOR REHEARING
AND

SUGGESTION OF APPELLANTS
ROY E. BREWER and BRADLEY R. BREWER
THAT REHEARING BE HEARD EN BANC

Appellants ROY E. BREWER and BRADLEY R. BREWER, respectfully petition this Court under FRAP, 40 for rehearing of its decision filed August 11, 1977, in the above-entitled appeal and suggest under FRAP 35(b) that rehearing, if granted, be en banc. Their reasons for requesting such relief are set forth below.

I

REASONS FOR EN BANC REHEARING
OF CERTAIN ISSUES OF THIS APPEAL*

- A. The court seriously misinterpreted the Supreme Court's holding in Green v. Santa Fe, acted contrary to other controlling Supreme Court precedents, and obliterated unnecessarily valid aspects of this Court's prior decisions in Green and Marshall v. AFW Fabric Corp.

*For the convenience of the seven active judges who were not members of the original panel and to whom this petition will be distributed under FRAP 35(b) because of appellants' suggestion of en banc rehearing, we will present first in this section the reasons under FRAP 35(a) why en banc re-consideration of certain major issues would be appropriate. Section II, infra, sets forth with specificity the reasons under FRAP 40(a) why rehearing should be granted by the original panel on points other than those as to which en banc review is requested.

We respectfully submit that the accuracy of the above statement is readily apparent from a careful reading of the relevant decisions, i.e., Green v. Santa Fe Ind., ___ U.S. ___, 45 U.S. L.W. 4317 (1977); August 11 decision in this appeal; this court's decision in Green, 533 F.2d 1283 (2d Cir. 1976); Marshall v. AFW Fabric Corp. 533 F.2d 1277 (2d Cir. 1976), CCH Fed. Sec. L. Rep. ¶95,448.

The present action is clearly distinguishable from Green because the federal securities claims in this case are based upon §14(a) of the 1934 Act, whereas the claims in Green involved §10(b); and 14(a) does not contain the restrictive language of 10(b) emphasizing fraud and deception that the Supreme Court found dispositive in Green. In holding Green dispositive in the present case, this Court erroneously regarded this as a 10(b) case rather than a 14(a) case. The authoritative Supreme Court interpretations of §14(a) are not Green, but three cases inexplicably not cited in the August 11 opinion and apparently overlooked by the court: TSC Industries v. Northway, Inc., 426 U.S. 438 (1976); Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970); and J.I. Case v. Borak, 377 U.S. 426 (1964).^{*} The teaching of those three

^{*}See, e.g., Wright v. The Heizer Corp. ___ F.2d ___ (7th Cir. 6-30-77), CCH Fed. Sec. L. Rep. ¶96,101 [Where the controlling stockholders cause the corporation to engage in a securities transaction in which those stockholders have a conflict of interest, they have "the obligation to disclose to the other stockholders information in...[their] possession which reflects on the fairness of the transaction," quoting from Bailey v. Meister Brau, Inc., 535 F.2d 982, 993 (7th Cir. 1976).]

authoritative 14(a) cases was ignored and patently contravened by the present decision. Section 10(b) is manifestly a "fraud" statute requiring as necessary elements of a claim both "scienter", Ernst & Ernst v. Hochfelder, 425, U.S. 185 (1976), and "manipulative or deceptive" conduct, Green, supra. In contrast, §14(a) is plainly a "strict liability" statute under which liability is imposed for the use of materially false or deceptive statements and omissions regardless of the state of mind of the defendant, a distinction that §14(a) shares, for example, with §5 of the Securities Act.*

In TSC Industries, the Supreme Court used language strongly indicating the existence of federal fiduciary duties in colorable actions under §14(a). The Court stated that the purpose of §14 (a) and Rule 14a-9 "is not merely to ensure by judicial means that the transaction, when judged by its real terms, is fair and otherwise adequate but to ensure disclosure by corporate management in order to enable the shareholders to make an informed choice," (Slip op. at 9). In Mills, the Supreme Court held (in language later quoted favorably in TSC) that, in deciding questions of materiality and "full and fair" disclosure

* Borak, supra; Mills, supra; Tital Group, Inc. v. Traggen, 513 F.2d 234, 239 (2d Cir. 1975); Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374, 381 (2d Cir. 1974), cert. denied, 421 U.S. 976 (1975); Shapiro v. Merrill Lynch, CCH Fed. Sec. L. Rep. ¶95,377 S.D.N.Y., 1975, Tenny, J.); Nat. Home Products, Inc. v. Gray, CCH Fed. Sec. L. Rep. ¶95,752; Gould v. American-Hawaiian S.S. Co., 351 F. Supp. 853, 858-865 (D. Del. 1972); Gerstle v. Gamble-Skogmo, Inc., 398 F. Supp. 66,97 (E.D.N.Y., 1969, Bartels, J.), aff'd, 478, F.2d 1281 (2d Cir. 1973); Richland v. Crandall, 262 F. Supp. 538, 553, n.12 (S.D.N.Y. 1967).

under §14(a), the federal courts should "resolv[e] doubts in favor of those the statute is designed to protect." That admonition was clearly ignored and contravened by both the district court and this court in deciding the 14(a) issues in this action.

This court mistakenly construed the holding of Green to be that a federal fiduciary duty claim in an action under the securities laws is "not one that may be presented under federal law," regardless of the nature of the federal statutory issues presented. In so holding, the court perceived in Green a broader and more rigid rule than the opinion of Justice White in Green actually contains. This was critical for determination of the present appeal, for only by taking the broadest and most expansive possible view of the teaching of Green could Judge Mansfield justify affirmance of the district court's dismissal of the fiduciary duty claims against DASA and the trustee bank. If this court had acknowledged the limitations plainly placed upon Green by the Supreme Court itself, a reversal on the merits of both the federal and the state fiduciary duty theories would have been required.

In Green, it was crucial that (i) the plaintiffs had not alleged any colorable or triable statutory claims of fraud or deception, (ii) that the claim of federal fiduciary duty was required to stand alone under 10(b), independent of any allegation of deception colorably purporting to satisfy the fraud and scienter requirements of that operative statute,

(iii) the federal fiduciary duty claim was dismissed at the beginning of the suit on a Rule 12(b) motion for failure to state a claim recognized by federal law, and (iv) once the federal claim was dismissed on what amounted to jurisdictional grounds, there was no jurisdictional basis for the district court to determine any pendent state law claims or theories of recovery. All of those facts make Green distinguishable from the present case, in which (a) the complaint did allege colorable and triable nondisclosure issues under §14(a) and Rule 14a-9; (b) DASA did not make any motion to dismiss either the nondisclosure claims or the federal and state fiduciary duty claims prior to trial; (c) the nondisclosure claims and the related fiduciary duty claims (state and federal) were agreed by DASA, at a pretrial conference, to be triable issues; (d) all of those issues were actually tried and decided by the district court.

In Green, the Supreme Court plainly rested its restrictive holding on the specific words of §10(b). It stated: "The language of §10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception." As we have seen, the Court used dramatically different words in TSC and Mills to describe the more expansive language, purpose, and reach of §14(a). Since the present case involved colorable and triable claims of both deception and manipulation, the federal fiduciary duty claims in this action would have been legitimately

triable under Green even if this had been a case under 10(b) instead of 14(a). Here the offer of a \$21 conversion price was a gross and indefensible manipulation by DASA and its directors of the interests of the proxied bondholders. In substance, it involved flagrant cheating of the beneficiary bondholders by the trustee directors. The bondholders were powerless in the circumstances to protect themselves against the equitable fraud perpetrated by DASA because failure to consent to the sale of assets (regardless of the unfairness of the consideration offered the bondholders) would unquestionably have forced DASA into bankruptcy---a circumstance of which the fiduciary directors took unfair advantage for reasons of personal economic gain. The overreaching of the bondholders was so gross and so indefensible that DASA did not once make any effort during the litigation to rationalize or to justify the grossly inadequate conversion price of \$21 as fair terms.

Moreover, Justice White went to great pains in Green to distinguish that case and the ambit of its holding from prior federal appellate cases under 10(b) upholding and enforcing federal fiduciary duties in securities laws actions, e.g., Affiliated Ute Citizens v. U.S., 406 U.S. 128 (1972); Superintendent of Insurance v. Bankers Life & Cas. Co., 404 U.S. 6 (1971); Schlick, supra; Drachman v. Harvey, 453 F.2d 722 (2d Cir. 1972); Schoenbaum v. Firstbrook, 405 F.2d 215 (2d Cir. 1968) (en banc); Pappas

v. Moss, 393 F.2d 865 (3d Cir. 1968); Shell v. Hensley, 430 F.2d 819 (5th Cir. 1970); Rekant v. Dresser, 425 F.2d 872 (5th Cir. 1970). The distinguishing material fact in all of these cases was stated by the Court to be the existence of colorable and triable allegations of manipulation or deceptive disclosure in violation of §10(b). In this case we had precisely such allegations, and they went to trial without being challenged by a motion to dismiss. So even if this had been a 10(b) case, it would have been improper under Green to avoid adjudication of the federal fiduciary duty claims.

Thus in Green the Supreme Court did not, as this Court held, obliterate and rule nonjusticiable in the federal courts all federal fiduciary duty claims. It merely narrowed the broad holdings of this court in Marshall and Green to the scope of Schlick, Drachman, Schoenbaum and Pappas. The August 11 opinion paints the holding of Green with too broad a brush and must, for that reason, be reversed by this court, sitting en banc to decide this important question concerning the justiciability of federal fiduciary duty claims in the district courts of this circuit under the Supreme Court decision in Green. *

*The Seventh Circuit has recently interpreted the Supreme Court's decision in Green and §14(a) in a manner that gives strong support to the foregoing argument. Wright v. The Heizer Corp., ___ F.2d ___ (7th Cir. 6-30-77), CCH Fed. Sec. L. Rep. ¶96,101.

- B. The opinion violated fundamental principles of federal jurisprudence, as set forth in Hurn v. Oursler, United Mine Workers v. Gibbs and related cases, which require simultaneous determination of federal law and state law theories of recovery arising from the same factual claim where the basic federal claims were neither insubstantial nor dismissed prior to trial.

There is no requirement in the federal civil rules that a pendent state law theory of recovery arising from the same factual claim or transaction as a federal law theory be pleaded in the complaint as a separate "claim". Rule 8(a) requires only a statement of a factual claim and a demand for relief arising therefrom. Rule 56(c) provides that "final judgment shall grant the relief to which the [winning] party is entitled, even if the party has not demanded such relief in his pleadings." "Under Rule 8...it is not necessary to set out the legal theory on which the claim is based." Spiegelman v. Cunard White Star, 221 F.2d 189, 196 (2d Cir. 1955).

Here the state law fiduciary duty theory was indicated in Claim 3, together with the federal fiduciary duty theory, as part of a claim which stated the factual claim of the aggrieved bondholders in the context of 14(a). The fact that there were "equity" or fiduciary duty theories of recovery involved in the action was stated early on, well known to all counsel, acknowledged by DASA before trial to raise issues involved in the trial, acknowledged by the district court at trial, and recognized by this court in the August 11 opinion.

Moreover, the district court recognized at trial that there were both federal law and state law fiduciary duty claims involved in the trial. The state law theory was dismissed from the bench on the second day of trial "as a matter of law" on the basis of a Delaware trial court decision, Harff v. Kerkorian, 324 A.2d 215 (Del. Ch. 1974), that was subsequently reversed after the trial but before the district court filed its post-trial opinion. 347 A.2d 133 (Del. 1975). The federal fiduciary duty theory was dismissed, also as a matter of law, in Judge Owen's post-trial opinion filed 1-12-76 (RD 115a)* on the basis of Abramson v. Nytronics, Inc., 312 F. Supp. 519, 524 (S.D.N.Y., 1970, Mansfield, J.). On motion for reargument, the district court refused to recognize the significance of either (i) the reversal of the Delaware Chancellor's decision in Harff or (ii) this court's dispositive decisions in Marshall and Green with respect to the federal fiduciary duty theory.

In its opinion, this court held that the federal fiduciary duty theory was "not one that may be presented under federal law" because of the Supreme Court's decision in Green. The court failed or refused to acknowledge the existence of the state law fiduciary duty claim and consequently failed to determine that issue on its merits or to remand it for reconsideration by the district court. At trial, the district court had refused to allow testimony

*RD refers to Record Document number. This appeal was argued on an expedited basis and on the original record (without appendix) by permission of the court.

as to either liability or damages on either the federal or the state fiduciary duty theory* in rulings which plaintiffs contend patently violated Rule 15 and Rule 43(c) and made the trial completely unfair.**

Plaintiffs maintain that this court's opinion violated fundamental principles of federal jurisprudence requiring the simultaneous determination of federal and state theories of recovery arising from the same facts. Hurn v. Oursler, 289 U.S. 238, n.1 (1938); Taussig v. Wellington Fund, Inc., 313 F.2d 472 (3d Cir. 1963); United Mine Workers v. Gibbs, 383 U.S. 715, 724-727 (1966)*** They maintain (i) that the law in this circuit is muddled and unclear on the question of when a district court is required to decide a so-called "pendent" state law theory of recovery arising from exactly the same facts as a federal claim actually determined and (ii) that this is "a question of exceptional importance" within the meaning of FRAP 35(a) and that "consideration by the full court is necessary to secure or maintain uniformity" of the decisions of this court and uniformity of practice among the district

* Plaintiffs succeeded in getting on the record only documentary evidence in the form of exhibits, affidavits and offers of proof.

** This court refused to rule on the Rule 43 arguments.

*** See, Newberger, Loeb & Co., Inc. v. Gross, F.2d (2d Cir. 8-24-77), CCH Fed. Sec. L. Rep. ¶96,148 at 92,189.

courts in this circuit on the question of when determination of "pendent claims" should be made and when it can appropriately be avoided.

In Gibbs, supra, Mr. Justice Brennan wrote

"Under the Rules, the impulse is toward entertaining the broadest possible scope of action consistent with fairness to the parties; joinder of claims, parties and remedies is strongly encouraged...The federal claim must have substance sufficient to confer subject matter jurisdiction on the court... The state and federal claim must derive from a common nucleus of operative fact." (383 U.S. at 724-727)

We submit that those requirements were clearly met by the state fiduciary duty theory in this action and that it was contrary to the federal civil rules and contrary to controlling Supreme Court precedent for this court to refuse to decide that theory on its merits, particularly in view of the fact that the district court had decided that issue.

- C. It was incorrect as a matter of law for the court to remand the question of an award of attorneys' fees on the ground that there was "evidence to support" a finding of "procedural bad faith" on the part of plaintiffs' trial attorney because (i) the doctrine of Hall v. Cole applies only to "bad faith claims or defenses on the merits," (ii) there is no general authority in the federal civil rules for an award of attorneys' fees on grounds of "procedural bad faith," (iii) the remand conflicts with Congressional policy as set forth in the securities laws and interpreted by this Court in Flaks v. Koegel and Van Alen v. Dominick & Dominick, (iv) the applicability of 28 U.S.C. §1927 to a fee award in this case was not presented or argued by any of the parties to this appeal, (v) the term "costs" used in 28 U.S.C. §1927 refers under well settled principles to court costs only and does not include attorneys' fees, and (vi) Rule 61 requires the district court to "disregard any error or defect in the proceeding which does not affect the substantial rights of the parties."

In its opinion, the court does not cite any authority for the general proposition that a federal claim exists for "procedural bad faith," and we respectfully submit (a) that no such authority exists and (b) that, in the absence of such authority, it was manifestly incorrect, as a matter of law for the court to remand this action for further hearings and a judgment for fees on the grounds stated.

The opinion clearly acknowledges that Hall v. Cole, 412 U.S. 1 (1973); Alyeska Pipeline Service Co. v. Wilderness Society, 421 U.S. 240 (1957); and F.D. Rich Co. v. Industrial Lumber Co., 417 U.S. 116 (1974), are all limited in that they justify an award of attorneys' fees only where a claim or defense has been determined to be frivolous on its merits. None of those authorities, or any other cited by the court, supports the existence of a catchall theory of "procedural bad faith." We submit that no such claim exists and that this theory of "procedural bad faith", which the court has attempted to create out of whole cloth in its opinion, is properly subject, on this reargument motion, to the equivalent of a Rule 12(b) dismissal motion for "failure to state a claim".

Moreover, this remand, issued in a securities class action case against plaintiffs' attorney, conflicts with federal policy as set forth in the securities laws and interpreted by the Second Circuit in Flaks v Koegel, 504

F.2d 702 (2d Cir. 1974) (the award of counsel fees on a punitive basis in a securities action is contrary to Congressional policy), and Van Alen v. Dominick & Dominick, Inc., ___ F.2d ___ (2d Cir. 8-15-77), CCH Fed. Sec. L. Rep. ¶96,136 (failure of Congress to provide expressly for a fee award precludes the district court from making one). Accord, Straub v. Vaisman & Co., 540 F.2d 591, 598-601 (3d Cir. 1976).*

There is no general authority in the federal civil rules for the award of attorneys' fees on a general theory of "procedural bad faith", although there are particular provisions in various individual rules under which counsel fees may be awarded upon specified grounds. For example, the opinion concludes that there was evidence of "procedural bad faith" in connection with "the making of frivolous motions for summary judgment against the Bank and Andersen", but Rule 56(g) permits the award of attorneys' fees only where "affidavits presented pursuant to this rule are presented in bad faith or solely for the purpose of delay." The summary judgment motions in question presented pure questions of law on the issue of liability in each case. No facts were in dispute and neither the bank nor Andersen challenged any affidavit as stating false facts. The legal theory of plaintiffs' claim against Andersen has been found by this court to have been at least "colorable" in combination with the various colorable nondisclosure claims against DASA with respect to financial statements which Andersen prepared and certified. So that theory of law was clearly not "frivolous" when presented as the basis

*Applicable provisions of the federal civil rules should be restrictively construed in this case in light of the admonitions of Flaks and Van Alen.

for a summary judgment motion on what plaintiffs argued were uncontested facts. Moreover, Andersen did not challenge that motion as "frivolous" or made in "bad faith" in its opposition papers. Indeed, the main argument made by Andersen's counsel in opposition to the motion was patently insupportable as a matter of law, as this court would have been forced to acknowledge if it had not avoided deciding that issue.

The Andersen summary judgment motion was hotly argued on pure issues of law, and Andersen's cross-motion to dismiss was granted on purely legal grounds---of which two out of three were clearly not sustainable on appeal. (The court picked the third ground, speculative damages, as the basis for affirming the dismissal and avoided deciding the other two, i.e., no allegation in the complaint of Rule 23 derivative action demand on Andersen and no claim under §14(a) against a certifying auditor for material misrepresentations in financial statements incorporated in a proxy statement. On those two points plaintiffs' appellate arguments were clearly entitled to prevail.)

On the summary judgment motion against the bank, Judge Owen resolutely refused to decide the legal question presented by plaintiffs' theory of recovery on its merits, and this court completely misapprehended plaintiffs' argument and described it incorrectly in the opinion. To date the merits of that argument have not been decided, either in the district court or in this court.

The opinion suggests that a "procedural bad faith" award can be made below for "the delay for discovery never conducted". That "delay" was caused by plaintiffs' inability to afford depositions by the use of court stenographers. Discovery by interrogatories and document production was conducted. When plaintiffs moved under Rule 30(b) before Judge Owen for permission to conduct depositions by non-stenographic means which they could afford, that motion was arbitrarily denied without any statement of reasons. On appeal, this court refused to decide the correctness of that ruling, but nevertheless affirmed the dismissal of certain claims for "lack of evidence"---conveniently ignoring the fact that the reason for the lacking evidence may well have been the improper denial of depositions. In any event, it is difficult to imagine what attorneys' fees could have been caused by a "delay" during which none of the defendants' attorneys did any work.

Similarly, the "motion to add parties" referred to by the court was never decided by the district court on its merits and this court similarly failed to analyze or to determine the merits of that motion, preferring instead to conclude vaguely that there was "ample evidence" of "procedural bad faith" without providing any indication, as to this or any other motion thus commented upon, what that "evidence" was.

The "threat to depose numerous Bank officers" was the subject of hot evidentiary dispute. The bank's attorney misquoted plaintiffs' attorney and called certain statements "threats". Plaintiffs' attorney called his statements simple statements of intent to subpoena trial witnesses if the bank persisted in its obstructive refusal to produce documents subpoenaed as trial evidence. As the result of the telephone conversation in question, the bank caved in and produced the documents at the trial, attacking plaintiffs' attorney in the process for making "threats". Again it is extremely doubtful that any significant fees at all were caused by the alleged "threats".

Violation of Rule 61. Moreover, the holding of evidentiary proceedings of the kind suggested in the court's opinion would seem clearly to violate that part of Rule 61 F.R. Civ. P., which provides, in mandatory language, that "the court at every stage of the proceeding shall disregard any error or defect in the proceeding which does not affect the substantive rights of the parties." It is absolutely inconceivable, and certainly was never argued or suggested by any of the defendants, that any of the "procedural steps" identified in the court's opinion had any effect whatsoever upon any of the "substantive rights" of any defendant. In the absence of probable cause

sufficient to support a reasonable belief that "substantial rights" were affected by one or more of those matters, we submit that Rule 61 requires that both the district court and this court "disregard" them.

- D. In light of the fact that (i) appellants were not allowed a sufficient number of pages to discuss the "procedural steps" remanded for further proceedings, (ii) none of the parties to the appeal raised or argued any of those issues at all, and (iii) appellants thus received no notice that those particular matters would be the subject of findings and conclusions not made by the court below in its award of fees, appellants were denied due process of law by this court because they were not given reasonable notice of those issues on this appeal or a reasonable opportunity to submit arguments on them.

We respectfully submit that the soundness of the foregoing argument is self-evident and requires no further elaboration.

We would direct the court's attention, in this connection, to the ABA Code of Professional Responsibility, which provides that "while serving as an advocate, a lawyer should resolve in favor of his client doubts as to the bounds of the law" (EC 7-3) and that "the advocate may urge any permissible construction of the law favorable to his client, without regard to his professional opinion as to what he believes would be the ultimate decision of the courts on the matter at hand." (EC 7-4) We respectfully submit

that this court's findings with respect to the particular "procedural steps" cited represent a form of censorship of the procedural and substantive legal arguments of plaintiff's counsel in derogation of those ethical imperatives and in violation of those aspects of due process, freedom of speech, and the right of petition which the Supreme Court has characterized as "the principle of free advocacy." F.D. Rich, supra, 417 U.S. at 129.

- E. It was manifestly erroneous for this court to remand for findings and fee assessments on grounds of "procedural bad faith" with respect to either of the two prior appeals in this action because (i) DASA moved before each of the panels who decided those ~~motions~~ *appeals* for findings of bad faith and frivolousness on the merits, and both panels declined to make such findings, (ii) the opinions of the court on those appeals indicate clearly that they were reasonably argued on the merits, (iii) if either of those appeals was "frivolous", it was on the merits of the appeal itself and not a matter of procedure, and (iv) it is not proper for the March 31 panel to attribute to the prior panels findings of "bad faith" or frivolousness which they did not make, and, if such findings are to be made, the relevant questions should be referred to the panels in question.

Because of the rapidity with which the indenture amendment took place after Judge Motley denied plaintiffs temporary injuncton motion on 5-8-72, plaintiffs did not have time to obtain an appellate determination before the computer sale was completed. On appeal after the fact, plaintiffs cited Mills for the proposition that an appropriate remedy

should be devised ex post facto if in fact Judge Motley had committed reversible error in lifting the preliminary injunction. The court accepted DASA's mootness argument and disregarded the argument based on Mills, which appellants' counsel still considers to be sound. It is quite significant that the March 31 panel has implicitly concluded that Judge Motley did in fact commit reversible error, because the panel concluded unanimously that "the fact that the present suit was instituted to force a further reduction in the conversion price does not necessarily mean that it was brought in bad faith". Judge Motley had reached precisely the opposite conclusion as one of her reasons for denying the preliminary injunction motion. Appellants' argument in this connection was not commented upon by the earlier panel.

With respect to the second appeal (with respect to dismissal of Claims 1 and 2 related to the stockholders' meeting), the issues were again hotly and vigorously argued by the parties. Plaintiffs' arguments were quite reasonably and were given serious consideration by the court in its opinion, 524 F.2d 811 (2d Cir. 1975). There is no suggestion in that opinion that the appeal was frivolous or brought in bad faith, and it is not proper for the March 31 panel to read any such implication into that opinion. If any such conclusion is to be reached, it should be done by the prior panel upon a proper referral from the March 31 panel or from the court en banc.

Moreover, if either of those prior appeals was argued in "bad faith", the issue obviously goes to the merits of the appeal itself and cannot be regarded as a mere "procedural step" as the court erroneously does in its opinion. In fact, there is no indication at all that the March 31 panel made any effort at all to review the arguments on the merits of the prior appeals. In the absence of such a review, it could not have been in any position to decide whether those appeals were argued reasonably by plaintiffs' attorney or not.

F. As interpreted by the district court and by this court, §315(e) of the Trust Indenture Act is unconstitutional.

Section 315, as interpreted in this case, is unconstitutional for a number of reasons.

It permits the district court to discriminate between federal court plaintiffs who sue indenture trustees on the basis of wealth by imposing, in its discretion, the requirement of an undertaking for the payment of the bank's counsel fees in an amount which the district court knows the plaintiff cannot afford. This is constitutionally pernicious on a number of grounds:

(1) It permits the district court to impose an impermissible financial burden on a plaintiff's First Amendment right to petition the federal courts for redress of grievances. The right to petition has been held to include the right to sue in federal court. Eastern Railroad President's Conference v. Noerr Motor Freight, Inc., 365 U.S. 127 (1961); United Mine Workers v. Pennington, 381 U.S. 657 (1965); California Motor Transport Co. v. Trucking Unlimited, 404 U.S. 508, 510 (1972).

(2) It violates equal protection of the laws in that it gives the district court discretion to limit access to the federal courts on the basis of means or accumulated wealth. Plaintiffs who have enough money to meet the district court's undertaking requirement will be permitted to sue an indenture trustee. Those who lack the requisite funds, as the present plaintiffs did, will be thrown out of court, without the district court making any ruling on the merits of the claim stated.

(3) It creates an impediment to suit against indenture trustee banks that is not placed in the path of suing other defendants for violation of the securities laws.

(4) It enables the district court to place its dismissal of an action beyond appellate review, because it enables the court to dismiss an action for failure to post a prohibitive bond without ruling on the merits of the claim

stated---as the district court did in this case. If the district court dismisses for failure to post a bond and refuses to rule on the merits of the claim and this court holds (as it did) that the district court had discretion to take such action, then a district judge can avoid ruling on the merits of the claim and the only issue on appeal will be whether or not he had discretion to require a bond. In those circumstances the question of whether or not the plaintiffs had a meritorious claim becomes lost in the shuffle and effectively placed beyond the scope of meaningful appellate review.

- G. Plaintiffs' claim against the bank was substantial and presented important issues of law under the Trust Indenture Act. The court completely misapprehended the nature of plaintiffs' argument and apparently overlooked the relevance to that argument of important case law authority.

Plaintiffs did not contend, as the opinion incorrectly states, that the bank had a duty, as indenture trustee, "to negotiate a better conversion price for the debenture holders," but rather that the bank had a duty, as a fiduciary, to notify its beneficiaries, the bondholders, of undisputed facts known to the bank which were essential in order for the bondholders to protect their rights and interests as security holders, namely, that grossly inadequate and therefore fraudulent terms were being offered to the bondholders in the DASA proxy

solicitation and DASA had admitted that it had made no attempt to offer a reasonable consideration to the bondholders in the form of a fair conversion price. At no time in the litigation did DASA make any attempt to justify the conversion price offer as fair or reasonable in the circumstances.

The court's misapprehension of plaintiffs' argument may explain why it apparently overlooked or failed to perceive the relevance of certain key cases to plaintiffs' contention that the bank owed its cestuis, the bondholders, not only the duties expressly set forth in the trust indenture (drafted, of course, by the bank), but also the duties imposed upon a trustee by general principles of equity. The relevant authorities were: Morris v. Cantor, 390 F. Supp. 817 (S.D.N.Y., 1975, Ward, J.); U.S. Trust Co. v. First National City Bank, 52 A.D. 2d 285, 394 N.Y.S. 2d 653 (1st Dept. 1977); and Kusner v. First Pennsylvania Corp., ___ F.2d ___ (3d Cir. 1976), CCH Fed. Sec. L. Rep. ¶95,475.

Another aspect of plaintiffs' case against the bank which the court either misapprehended or overlooked was the argument that (i) the bank owed a fiduciary duty of notification to the bondholders under state law principles as well as federal law and (ii) §315(e) did not

authorize the district court to impose the condition of a prohibitive \$25,000 undertaking upon prosecution of the "pendent" state law theory of recovery in the absence of state law authority to take such action, which neither the bank nor the district court ever cited.

H. It was manifestly erroneous and a violation of due process of law for this court to affirm dismissal of the claim against Andersen, because the nature of the claim was misunderstood and controlling Supreme Court authority was overlooked.

In affirming the dismissal as to Andersen on the ground that damages caused by defects in the financial statements would be "speculative" and not ascertainable, the court apparently overlooked the fact that (1) if a recklessly improper audit and certification letter caused the proxy statement to materially misrepresent DASA's financial condition, then §14(a), as authoritatively interpreted by the Supreme Court, creates a conclusive presumption that the security holders would not have approved the transaction and (2) plaintiffs had presented proof at trial (Exhibits 112 and 115) that completion of the indenture amendment on the terms set forth in the DASA offer caused collective damages of over \$2.0 million to the solicited bondholders, and DASA introduced no evidence to convert that proof as to damages.

In so holding, the court apparently overlooked controlling authority in J.I. Case v. Borak, 377 U.S. 426 (1964), and Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970), to the effect that damages need not be proven in a §14(a) case and that appropriate injunctive relief must be fashioned by the court if a statutory violation is found in order to effectuate the purpose of the statute. Here the district court could have invalidated the proxy solicitation if it was tainted by material misrepresentation and required DASA to resolicit the 1972 bondholder list using appropriately corrected proxy materials.

The construction given §14(a) by the court's opinion would make that statute virtually a dead letter, because the nature of proxy solicitation is such that there are many material violations of the disclosure requirements that may drastically affect or even destroy altogether the integrity of the proxy voting process without producing readily ascertainable damages. See, Berman v. Thomson, 312 F. Supp. 1031 (D. Ill. 1920); duPont v. Wyly, 61 F.R.D. 615, 629 (D. Del. 1973). The court's construction of §14(a) as it applied to Andersen would encourage such violations of law and thus tend to render the statute meaningless.

- I. It was manifestly incorrect under Rule 23 and a violation of due process of law to the members of the class of solicited bondholders for the court to refuse to decide whether or not class action certification was erroneously denied by the district court.

The foregoing statement is valid because if class certification and notice to the class were required under Rule 23 but erroneously denied by the district court early in this action, then the class members were denied due process of law and their rights under Rule 23 were violated since they were denied reasonable notice and an opportunity to intervene in the action. It may very well be possible, for example, that, if class action notices had been sent out, a class member might have intervened who was wealthy enough to conduct through his own counsel the depositions by ordinary stenographic methods which Judge Owen required of the present plaintiffs but which they could not afford.

II

ADDITIONAL REASONS WHY REHEARING SHOULD BE GRANTED BY THE ORIGINAL PANEL.

- J. The opinion clearly indicates that the court misapprehended plaintiffs' argument on the dismissal of the claim in ¶22(u) of the complaint.

The argument was that plaintiffs introduced into the record clear evidence of post-trial events proving the allegations of ¶22(u) of the complaint.

The statement in the opinion of the court's belief that "if all security holders tendered promptly, the company might be unable to fulfill the promise" made in the DASA solicitation letter demonstrates unmistakably a complete misunderstanding of both the nature of the solicitation and the nature of plaintiffs' argument in this connection.

The court's statement seems to assume that the solicitation letter tendered the payment of money which was in limited supply and might run out, thus leaving those who failed to tender promptly without any benefits. In fact, the only consideration offered was a conversion price reduced to \$21.00. Once the requisite two-thirds majority of proxy consents was collected by DASA, that consideration would clearly be available uniformly to all of the bondholders, regardless of when they tendered their proxy---including those who submitted no proxy at all.

Plaintiffs' argument was not, as the court incorrectly assumed, a failure of the proxy statement to disclose a plan to offer a further conversion price reduction "only to those who would agree to convert...immediately," but rather a failure to disclose that the reason why a grossly inadequate and fundamentally fraudulent conversion price was offered in this solicitation was that DASA planned

to make a subsequent and further reduction offer in exchange for the sacrifice of additional rights by the bondholders. The existence of such a plan was clearly a material fact which any reasonable bondholder would have wished to be told about before he decided whether or not to submit his proxy consent to DASA's management. The proof of post-trial events introduced by plaintiffs into the record (RD 134) shows that the undisclosed plan (described in Browning's testimony, RD 130, pp. 142, 178), was actually carried out by DASA in July of 1976. In his post-trial opinion (RD115a, p. 12), Judge Owen had overlooked the existence of trial testimony by Browning on this subject (RD 130, pp. 142, 178) and dismissed this allegation on the erroneous ground that "no-evidence was offered on this subject." Once proof of consummation of the plan was submitted to Judge Owen in July of 1976, he obviously should have amended his opinion pursuant to Rule 60(b), as plaintiffs requested. But he did not.

In light of the court's evident misunderstanding of the relevant facts and arguments in this connection, reargument should be granted.

- K. The court apparently misapprehended the operative facts in connection with plaintiffs' motion to amend the complaint.

The opinion incorrectly describes this motion as "appellants' post-trial motion to amend the complaint." Thus the court indicated that it had overlooked the fact that plaintiffs had made a motion under Rule 15 that the complaint be deemed amended to conform to the proof on the first day of the six-day trial and at the time when the relevant plaintiffs' evidence was offered for the record. (RD 204, Transcript of Wagner's testimony, p.60.) Consequently, plaintiffs had moved early in the trial that the complaint be deemed amended to include the allegations later set forth in a formal post-trial motion to amend. The court apparently assumed, incorrectly, that the written post-trial motion was the only Rule 15 motion plaintiffs had made.

The court apparently overlooked two other important facts as well: (1) that DASA made no objection of actual or possible prejudice (as required by Rule 15) either at the time of the trial motion or in response to the post-trial motion and (2) any such arguments that DASA might have made could have been easily accommodated by simply adjourning this bench trial to a later date so that DASA could present its proof. But DASA made no ob-

jection of prejudice, so the district court had no occasion to consider the possibility of adjourning the trial. In fact, DASA filed no papers at all in opposition to the post-trial motion under Rule 15.

In the circumstances, the court's conclusions concerning possible prejudice to DASA if the pleadings had been amended were purely speculative in nature and based upon a palpable misreading of the record.

In light of the facts with respect to plaintiffs' Rule 15 motions as actually reflected in the record, it is evident that the trial was manifestly unfair to the plaintiffs because they were denied a reasonable opportunity to introduce relevant evidence in the absence of a showing of prejudice by the defendant.

- L. The court apparently misapprehended the facts concerning plaintiffs' motion for summary judgment on the ground that the solicitation offer constituted an unregistered sale of securities in violation of §5 of the Securities Act.

The court's description of this motion as having been made on "the eve of trial" indicates a misapprehension of the facts, for this motion was made three months before the trial. We submit that recognition of this factual error will require reversal of the court's conclusion that to have allowed amendment of the pleadings to encompass this claim "would have substantially prejudiced DASA."

The court was clearly mistaken about the nature of the trial when it concluded that "DASA was led to prepare a case in support of the proposition that the preferred conversion rate was fair." In fact DASA did not prepare or present any case at all in support of that proposition. In fact, at no time in the entire five year history of this litigation has DASA ever argued---or even suggested---that the \$21 conversion price offer was "fair". And they certainly did not present any "case" for that proposition at trial, either by argument or by evidence. The court's conclusion that DASA prepared such a case is totally without support in the record. DASA's "case", such as it was, was simply that DASA owed no fiduciary duty of fairness to the bondholders, and because that is so it made no difference whether the price offered was grossly inadequate or not.

A third mistake of fact reflected in the opinion arises from the fact that "the overall marketplace significance of the change in conversion rate" was not relevant to the \$5 issue at all, and it is a complete mystery what caused the court to think that this factor was somehow involved.

The \$5 claim presented a pure issue of law which would have required no evidence at trial from either side.

DASA never contended that an amendment of this kind would be prejudicial to its preparations for trial. Indeed, it could not have done so, because plaintiffs' motion papers under Rule 56 were filed three months before trial. The arguments on both sides dealt exclusively with points of law. There is absolutely no explanation for this court's repeated insistence, in its opinion, upon making findings of probable prejudice to DASA when its counsel did not make any such argument and in fact could not rationally have done so.

CONCLUSION

For all of the reasons set forth above and in appellants' brief and reply brief submitted on this appeal, the relief requested in this petition should be granted and this Court, sitting en banc, should review the opinion of August 11 and the opinion of the district court below with respect to those points denominated A through I above.

Dated: New York, New York
August 25, 1977

BREWER & SOEIRO

By Bradley R. Brewer
Bradley R. Brewer
A Member of the Firm
Attorneys for Appellant
257 Park Avenue South
New York, New York 10010
(212) 777-4010

CERTIFICATE OF SERVICE

The foregoing document was () hand delivered
(X) mailed to counsel for all other parties on
9-16-22. The undersigned attorney
affirms the foregoing statement to be true under the
penalties of perjury.

BREWER & SOEIRO

By Bradley R. Brewer
A Member of the Firm